



UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.

Order 97-3-8

Issued by the Department of Transportation
on the 7th day of March, 1997

SERVED: March 7, 1997

**1997 U.S.-Brazil Combination Service
Proceeding**

Docket OST-96-2016

ORDER TO SHOW CAUSE

Summary

By this order we tentatively select Continental Airlines, Inc., and Delta Air Lines, Inc., for primary authority and Delta Air Lines, Inc., and Tower Air, Inc., for backup authority to serve the U.S.-Brazil market. We also tentatively allocate to Continental 14 weekly frequencies and to Delta 7 weekly frequencies to conduct their proposed services. We will afford interested parties 10 calendar days to file objections to our tentative findings and conclusions and 5 calendar days for any answers.

Background

Under the U.S.-Brazil Air Transport Agreement, as amended by a Memorandum of Consultations signed October 24, 1996, the United States may designate a total of four U.S. carriers for scheduled combination services effective April 1, 1997, and the designated carriers may operate collectively a total of 98 weekly frequencies for combination air services. American Airlines, Inc., and United Air Lines, Inc., have been designated to provide long-term services in the market. Tower Air has been granted temporary authority to use the third designation and has been serving the U.S.-Brazil market *undependente lite* authority since 1993. Delta also serves the U.S.-Brazil market under a code-share arrangement with Varig Brazilian Airlines on flights operated by Varig¹.

¹ Under the terms of the U.S.-Brazil aviation agreement, Delta's operations do not count against the designation limitations for U.S. carriers. Prior to the Memorandum of Consultations, Delta's operations with Varig were permitted on an extrabilateral basis. On February 7, 1997, Delta filed a statement notifying us that its code-share agreement with Varig had been terminated, which is discussed *infra*.

By Notice served November 6, 1996, the Department solicited applications from carriers interested in providing combination services in the U.S.-Brazil market. By Order 96-12-9, the Department (1) instituted this proceeding to certificate carriers for the third- and fourth- U.S.-carrier designations for U.S.-Brazil combination service and to allocate 21 weekly frequencies among designated U.S. carriers; and (2) established a procedural schedule for the proceeding, calling for Direct Exhibits January 6, 1997; Rebuttal Exhibits, January 17, 1997; and Briefs to the Decisionmaker, January 31, 1997.

In our instituting order we stated that in determining which carriers/gateways would be authorized, our principal objective would be to maximize the public benefits that would result from award of the authority in this case. In this regard we stated that we would consider which applicants would offer and maintain the best service for the traveling and shipping public, and would most improve the overall market structure and level of competition in the U.S.-Brazil market and any other market shown to be relevant, in order to promote an air transportation environment that would sustain the greatest public benefits.²

The Market

The U.S.-Brazil market is the largest market for passenger services between the United States and South America, and has steadily grown over the past five years. For the year ended March 31, 1996, Department T-100 data indicate that 920,000 passengers traveled between the United States and Brazil on U.S.-flag services and 1.25 million passengers traveled on foreign-flag carrier services. Nearly 73% of these passengers used two U.S. city gateways, Miami (50.8%) and New York (22.2%). Los Angeles is the third largest gateway accounting for 14.7% of the traffic. According to O&D data, Sao Paulo and Rio de Janeiro are the most popular Brazil destinations, accounting for over 600,000 passengers carried on U.S. carrier services (386,580 in the Sao Paulo market and 222,890 in the Rio de Janeiro market).

Applicant Proposals

Four carriers--Continental, Delta, Tower, and American--filed applications for the available authority and filed direct and rebuttal exhibits and briefs.³ The New Jersey Parties filed in support of Continental's proposal. The Georgia and Atlanta Parties and the Cincinnati/Northern Kentucky Parties filed in support of Delta's proposal.⁴

² Order 96-12-9, at 5.

³ In connection with its Direct Exhibits, Delta filed a motion for confidential treatment pursuant to Rule 39 concerning portions of exhibits that contain confidential international O&D data not publicly released under the Department's instituting order. We will grant the motion.

⁴ The New Jersey Parties represent the Mayor, City of Newark and the Regional Business Partnership (Newark). The Georgia and Atlanta Parties include the State of Georgia, the City of Atlanta, Hartsfield Atlanta International Airport, and the Metro Atlanta Chamber of Commerce. The Cincinnati/Northern Kentucky Parties include the City of Cincinnati, The Cincinnati/Northern Kentucky International Airport, the Greater Cincinnati Chamber of Commerce, and the Northern Kentucky Chamber of Commerce.

Of the four applicants in this proceeding, three carriers (Continental, Delta, and Tower) seek certificate authority as well as a frequency allocation to operate their services. American seeks only additional frequencies since it already holds certificate authority for U.S.-Brazil services. All four carriers propose services with wide-body aircraft.

Continental proposes service from its hub at Newark offering nonstop service to both Sao Paulo and Rio de Janeiro and seeks 14 weekly frequencies for its operations. Delta proposes service from its hub at Atlanta and from New York (JFK) offering nonstop service to Sao Paulo from both gateways and single-plane service to Cincinnati on its Atlanta flights and single-plane service to Rio on its New York flights. Delta seeks 14 weekly frequencies for its proposal. Tower proposes service from Miami to Sao Paulo and Rio de Janeiro with single-plane service to New York and seeks seven weekly frequencies for its service. American proposes service to a new city, Manaus, from its Miami hub and seeks seven weekly frequencies for its service. The carriers' proposals are fully described in the chart in Appendix A.

Positions of the Parties⁵

Continental argues that it should be selected for one of the available designations and allocated 14 weekly frequencies for its proposed services. In support of its proposal, Continental states that it will carry more U.S.-Brazil passengers and offer more U.S.-Brazil seats than any other applicant and will offer Newark/New York passengers nonstop service in both the Sao Paulo and Rio de Janeiro markets. Continental further argues that it is the only new entrant applicant in this proceeding, and that as a new entrant in the market, it maintains that only its proposal will open a new gateway for U.S.-Brazil traffic, will add an additional domestic network to the U.S.-Brazil hub services currently available, and will offer new competitive nonstop-to-nonstop connecting service for numerous cities in the U.S.-Sao Paulo and U.S.-Rio de Janeiro markets. Continental further states that it will provide both intragateway competition in the Newark/New York-Brazil market and new intergateway competition with Miami, Atlanta, and Dallas/Ft. Worth in the U.S.-Sao Paulo and U.S.-Rio de Janeiro markets. Moreover, Continental states that it is the only applicant with a track record of building a South America network to compete with American, the dominant U.S. carrier, and with South American flag carriers. Thus, it argues that only its selection will enhance overall U.S.-South America competition through its ability to compete effectively in South America and to serve points in Central and South America with a U.S.-Latin American identity.

Continental's proposal is supported by the New Jersey Parties, which note that Newark International Airport is the sixth largest mainland U.S. international gateway, and the only proposed U.S. gateway in this proceeding that has no nonstop or single-plane Brazil service, and that Continental is the only applicant without on-line U.S. Brazil authority. They also argue that only Continental's Newark proposal gives passengers in the New York

⁵ We highlight the carriers' proposals here. We go into more detail as to the carriers' positions on the other parties' proposals and the comments of the civic parties in Appendix B.

Metropolitan area a choice of airports not currently available for both Sao Paulo and Rio de Janeiro service.

Delta also argues that it should be selected for one of the two available designations and allocated 14 weekly frequencies for its services. Delta states that its Atlanta proposal will inject the strongest and most effective network competition against the entrenched incumbents. It further argues that its daily New York-Brazil flight will (a) inject needed competition at the largest northeast gateway and in the second largest U.S.-Brazil market and (b) provide global network competition for traffic moving between Europe and Brazil. Delta states that it is the only applicant proposing service from two U.S. gateways and single-plane service linking Brazil to two major U.S. hubs, that its Atlanta hub is larger than the gateway hubs of any incumbent or applicant carrier, and that its Cincinnati hub is larger than the gateway hubs of any applicant or incumbent carrier (except Dallas/Ft Worth). It maintains that it will carry more U.S.-Sao Paulo traffic than the other applicants and that its service will offer an effective challenge to American. Delta further states that an award of fourteen frequencies to it for its proposed Atlanta and New York services and seven to Continental for Newark-Brazil service would enhance intragateway competition by installing two additional major U.S. carriers in the large New York-Brazil gateway.

Delta's proposal is supported by the Cincinnati/Northern Kentucky Parties and the Georgia/Atlanta Parties, which state that Delta's proposal will provide much needed service to two large regions of the United States (midwest and southeast), and that its Cincinnati-Atlanta-Sao Paulo service provides more cities with first round-trip nonstop-to-nonstop connections than all the other applicants combined. They maintain that Delta's services from its two main hubs in Cincinnati and Atlanta will enable Delta to be a significant competitor to Miami and Dallas/Ft. Worth services; and thus, that the selection of Delta's Cincinnati/Atlanta-Brazil service will provide the greatest market structure and competitive benefits in this case.

By letter dated February 7, 1997, Delta informed the Department that its code-share relationship with Varig had been terminated by Varig on February 3, and that Delta now will be a new entrant in the U.S.-Brazil market and will be unable to provide any competitive service to Brazil in the absence of an award in this case⁶

Tower argues that it should be selected for one of the available designations and allocated seven weekly frequencies for its service. Tower states that it is the only carrier proposing to offer low-fares for its proposed New York-Miami-Sao Paulo/Rio de Janeiro services which it initially plans to operate three times a week and to increase to seven weekly flights after it acquires either B767 or A310 aircraft. It maintains that the proposals of the other applicants are virtually the same as those of incumbents in the market and that the real issue in this proceeding is the ability of carriers to compete head-to-head in two markets which account for over 60% of travelers--Miami and New York. Tower argues that its past and present services

⁶ Several carriers filed comments to Delta's letter. We discuss in more detail Delta's filing and the responsive comments, *infra*.

in the market should enable it to increase its services, rather than deprive it of its international routes.

American takes no position on which carriers should be selected for the two available designations but argues that it should be allocated additional frequencies for its proposed service. American argues that it is the only applicant proposing services in a new market; that it will offer the first on-line Manaus service to 28 cities; and that such service offers the first U.S. carrier service to the principal city in the Amazon region of Brazil, which currently receives very limited service from the United States and is served only by Brazilian-flag carriers. It further states that nonstop service between Miami and Manaus will enable American to use its hub strength at Miami to develop a new market for the benefit of the traveling and shipping public, and that this service offers greater public benefits than additional services in already well-served markets.

Tentative Decision

Designations

We have tentatively decided to select Continental and Delta for primary awards, and Delta and Tower Air for backup authority in the U.S.-Brazil market.⁷ We also tentatively allocate to Continental 14 weekly frequencies and to Delta 7 weekly frequencies for their proposed services.

The U.S.-Brazil market is the largest U.S.-South America market, generating over 2 million passengers annually on U.S. and foreign carrier services. This proceeding affords us an important opportunity to increase U.S. carrier services and thereby enhance the overall U.S. presence in this important market and to increase competition, not only among U.S. carriers, but also among the U.S. and foreign carriers that offer services.

After a review of all of the proposals in this case, we tentatively conclude that the proposals of Continental and Delta offer the greatest public benefits and should be selected for the two available designations in this proceeding.

First, both carriers propose service to the two largest Brazilian markets--Sao Paulo and Rio de Janeiro. Continental would provide nonstop service to both cities from Newark; Delta would provide nonstop service to Sao Paulo from two gateways, Atlanta and New York, and single-plane service to Rio de Janeiro from New York. Second, these carriers propose to carry the most traffic, thereby benefiting the largest number of passengers. As shown in Appendix A, Continental projects 233,901 passengers in its first year of service from its Newark hub and Delta projects 231,429 passengers from its Atlanta and New York services. American and Tower, on the other hand, project 87,044 and 97,672 annual passengers, respectively, from

⁷ Based on officially noticeable data, we find that all applicants are fit, willing and able to provide the proposed services. All of the applicants have previously been found fit to provide scheduled foreign air transportation of persons, property, and mail. See Order 96-10-44 for American; Order 96-12-25 for Continental; Order 96-10-30 for Delta; and Order 97-1-10 for Tower.

their daily services, significantly less than half the traffic projected by Continental and Delta on their double daily operations.⁸ Third, and particularly significant, Continental and Delta offer the greatest behind gateway benefits to the largest number of passengers by offering service from their major hubs--Continental from Newark and Delta from Atlanta. Continental would serve over 45,000 passengers over its Newark hub and Delta projects over 80,000 passengers over its Atlanta hub and 5,000 passengers on its New York (JFK) service. American, on the other hand, projects fewer than 5,000 passengers over its Miami hub in the Manaus market and Tower projects no flow traffic at all on its Miami service⁹. Thus, not only do the proposals of Continental and Delta offer new services to the local markets, they benefit the greatest number of behind-gateway passengers as well, affording them alternative service options for travel in the U.S.-Brazil market.

In addition to the greater number of passengers that will benefit from the hub operations of these carriers, the network systems of these carriers at their hubs also offer the greatest competitive benefits. Competition in this case is a particularly significant consideration, as services in the Brazil market are limited, and as so many of them are operated by just two carriers, American and Varig. American operates 49 weekly frequencies from three gateways, and Varig operates 41 weekly frequencies from four gateways. The opportunity to increase competition with 21 additional weekly frequencies, therefore, is significant. Not only will Continental and Delta offer competition to American and Varig, but also to United which holds the second largest allocation of frequencies in the U.S.-Brazil market (28). United has recently announced plans to use some of its frequencies to commence service at its hub at Chicago.¹⁰ The services of Continental and Delta from their respective hubs will maximize their ability to compete with American's hub operations at Miami and Dallas/Ft. Worth, as well as United's at Chicago, offering significant intergateway competitive benefits. They will also promote their ability to compete with the Brazilian carriers that offer services from four U.S. gateways, Miami, New York, Los Angeles, and Atlanta, strengthening the U.S. carrier presence in the U.S.-Brazil market.

The combination of these factors--greater frequencies, greater number of passengers served in both local and behind gateway markets, and the service and competitive benefits from the introduction of two new hub services--tentatively persuade us that Continental and Delta offer the greatest public benefits in this case and should be selected for the two available designations.

Tower and American have argued to the contrary, suggesting that authorization of their services would provide the greatest public benefits.

Tower maintains that it has served the market under temporary authority and should not be required to withdraw from the market in favor of another carrier. It also asserts that it is the

⁸ Tower's operations would be less than daily for at least 9 months of the forecast year.

⁹ As discussed later in this order, Tower did not provide the detail necessary in its traffic forecast to determine whether any of its forecast traffic includes flow traffic from its own operations or interline traffic from other carriers.

¹⁰ Brief of Delta Air Lines, at 20-21.

only low-fare applicant in the case and would, therefore, provide needed fare competition in the market. We do not dispute that Tower's proposal might provide public benefits. However, we tentatively conclude that the benefits of its proposal do not outweigh the clear advantages offered by the proposals of Continental and Delta. Tower proposes service from the most well-served U.S.-Brazil gateway--Miami, which currently receives over 85 weekly flights between the U.S. and Brazil. The majority of these flights are operated in the Miami-Sao Paulo/Rio de Janeiro markets, the same markets Tower proposes to serve. New York, the second largest U.S.-Brazil gateway, receives 48 weekly flights and Atlanta only seven weekly flights. While Tower does propose single-plane service to New York, only 21% of its traffic forecast (20,356 passengers) is projected from New York, clearly indicating a focus on the well-served Miami market and fewer benefits to the New York market.¹¹ In addition, as other carriers have noted and Tower has not refuted, Tower does not have a domestic route network to support its proposed services.¹² Although Miami has a significant local market, a large portion of the traffic at Miami is connecting traffic flowing over the gateway to Brazil from other cities in the United States.¹³ Many of these passengers could be better served on the domestic services of Continental and Delta over their hubs!¹⁴ Thus, Tower's proposal does not offer the competitive network advantages clearly provided in the proposals of Continental and Delta. Furthermore, Tower offers the fewest frequencies of any of the applicants, initially proposing only three weekly frequencies (two to Sao Paulo and one to Rio de Janeiro), which would not increase to a daily service (four flights to Sao Paulo and 3 to Rio) until after it acquires new aircraft for the route in 1998!¹⁵ Given the high level of existing service in the Miami-Sao Paulo and Rio de Janeiro markets, most of which is provided on a daily or double daily basis, we seriously question the competitive impact that Tower's less than daily proposal would offer.

Nor are we persuaded by Tower's argument that its proposed low fares warrant its selection in this case. We support the provision of low-fare services, and we seek, even in limited entry situations such as here, to provide as competitive an environment as possible to promote low fares to the public. Indeed, it is the service and competitive benefits of Continental's and Delta's proposals, particularly the operation of services from their major hubs, that lead us tentatively to select them for awards in this case. We believe that the introduction of two new carriers operating services from their major hubs will provide an important incentive to all carriers serving the market to ensure that competitive price and service options will be available to the public. While Tower's proposal to offer low fares in the market is a positive attribute of its proposal, we do not believe that it overrides the positive benefits of Continental's and Delta's proposals to justify Tower's selection in this case.

¹¹ Tower Direct Exhibits, TWR-111.

¹² Continental Rebuttals, CO-RT-1 at 2.; Brief at 6; New Jersey Parties Brief at 4.

¹³ DOT-IR-3.

¹⁴ Traffic flowing over Miami comes from various cities including Atlanta, Boston, Chicago, Cleveland, Los Angeles, Minneapolis, New York and Washington, all of which are included in the behind-gateway proposals of Continental and Delta.

¹⁵ Tower Direct Exhibits, TWR-100 at 1 and TWR-101.

Similarly, we are unpersuaded that American's proposal offers superior benefits. The market American seeks to serve, Miami-Manaus, is one of the smallest U.S.-Brazil markets, and American projects the fewest passengers for its service of any of the other applicants in this case. O&D data indicate only 200 passengers for this market and 1,220 passengers for the U.S.-Manaus market as a whole for the calendar year ended March 31, 1996.¹⁶ Furthermore, we believe that American's proposal offers the fewest competitive advantages. American already operates half (49) of the total number of frequencies available to all four U.S. carriers that may be authorized to serve the U.S.-Brazil market. While American's operations would compete with the Brazilian carrier services in the market, these carriers operate only three weekly flights to Manaus. Given the small size of the market, we tentatively conclude that the competitive benefits of U.S. flag competition with these services would be small and, on balance, considerably less valuable than increased competition from an award to other carriers.¹⁷

In reaching these conclusions, we have considered the arguments made by Tower and American against Continental and Delta.

Both of these carriers and Delta argue that Continental's forecast is inflated. In this regard they cite two major considerations. First, they criticize Continental's methodology in developing its local market forecast in the Newark-Brazil market. Second, they argue that Continental's forecast of behind gateway passengers is overstated because the routings are too circuitous. Continental developed its forecast for Newark by applying Newark's share of seats in the New York-Brazil market to the historic level of New York-Brazil traffic from the Department's Information Responses, assuming Continental's service in the market. It then added foreign flag carrier traffic to the base, as well as growth based on historical figures and stimulation based on Continental's own experience in introducing Newark services in similar markets. While we do not necessarily endorse all aspects of Continental's methodology, we tentatively believe that, given the level of traffic traveling between New York and Brazil for the year ended March 31, 1996 (nearly 500,000 passengers); the fact that Continental would be introducing service at a new, less congested airport; and the historic growth in the market (20% over the period 1993-1996),¹⁸ its overall Newark-Brazil forecast is credible. Indeed, we note that Continental's forecast for Newark-Sao Paulo passengers is comparable to Delta's. While Delta has argued that passengers prefer JFK and would not use Newark to the extent that Continental suggests, it has provided no evidence of such preference in its exhibits.

¹⁶ DOT-IR-2M.

¹⁷ We note that American's forecast is criticized for excessive stimulation (400%). Given the low starting traffic bases, we do not find it would be unreasonable to assume that were American awarded frequencies for this service, that it could develop the market as projected, and we do not find that its forecast is unreasonable. Delta has also criticized American's forecast, arguing that American has highly inflated the base year traffic figures for its Miami-Manaus proposal. We disagree. American used O&D figures as provided in the Department's IR's and supplemented that data with traffic by foreign carriers and charter traffic as reported in the Department's IR's in this case. Delta similarly used this approach in developing its own traffic forecasts. See American Direct Exhibits AA-310 and -311 and Delta Direct Exhibits DL 302 and -306.

¹⁸ DOT-IR-1.

Moreover, Continental has succeeded in providing service from Newark in several markets where service on other carriers from JFK is also available!¹⁹

We have also examined Continental's flow traffic forecast and find it credible. First, historic traffic in the market indicates that nearly 20% of the traffic at New York consists of connecting passengers flowing over the New York gateway from other U.S. cities.²⁰ Continental's forecast of 45,555 passengers is approximately 20% of its total Newark-Brazil forecast. Furthermore, of its projected flow traffic forecast, 75% of Continental's proposal is from nine cities.²¹ Of these, Continental offers comparable or better connections to Brazil over Newark than Delta's service over Atlanta or American's service over Miami in several markets.²² In these combined circumstances, we do not find Continental's projections to be outside the zone of reasonableness.²³

Delta is criticized primarily on its Atlanta-Brazil proposal for overstating the support traffic it would generate and for serving a market with a small local traffic base. The focus of the criticism is Delta's inclusion of passengers who must double connect to use Delta's service to Brazil, as well as single-connection traffic over Cincinnati which Delta will serve behind Atlanta. We agree that Delta's forecast may be overstated by inclusion of this traffic. However, we tentatively find that even excluding the double-connection traffic (4,292 passengers), Delta's proposal will benefit a significant number of passengers.²⁴ Atlanta is geographically well situated as an alternative gateway to American's Miami and Dallas/Ft. Worth hub services. Given that over 50% of the traffic at Miami consists of passengers flowing over the gateway, and given Delta's large hub at Atlanta offering services throughout the United States, we believe that Delta's proposed Atlanta services offer significant intergateway competition which would provide meaningful service alternatives for thousands of passengers. While the Atlanta-Brazil local market may be relatively small, we tentatively conclude that the behind-gateway benefits of Delta's Atlanta proposal outweigh any concerns over the size of the Atlanta local market.

¹⁹ Newark-Bogota, Colombia; Newark-Lima, Peru; Newark-Guayaquil, Ecuador. See Continental Direct Exhibits CO-203 and 505; and Rebuttal Exhibits, CO-RT-1 at 4, CO-R-1124 and CO-R-1125.

²⁰ DOT-IR-3.

²¹ Chicago, Washington, Detroit, Boston, Cleveland, Minneapolis, Los Angeles, Las Vegas, and San Francisco. Continental Direct Exhibits CO-301.

²² For example, the elapsed time on Continental's Boston-Sao Paulo service is 12 hours and 25 minutes, but 14 hours over Atlanta and 13.5 hours over Miami. For Las Vegas the elapsed time on Continental is 15 hours and 25 minutes as opposed to nearly 18 hours over Atlanta.

²³ Delta also argues that Continental will not offer first-class service on its flights which seriously detracts from its proposal, and that Delta will provide three classes of services--first, business, and economy--on its flights. As Continental notes in its exhibits, it will offer two classes of service--business/first and economy on its Brazil services. These services are currently provided on flights operated by Continental in similar markets and compete with services of other carriers offering separate first and business class services. In these circumstances, we are unpersuaded that the two-class service offered by Continental on its proposed operations detracts from its proposal or otherwise warrants selection of Delta over Continental for services in the New York market.

²⁴ Delta Direct Exhibits DL-302.

The second major criticism of Delta's proposal is that it is already an incumbent in the market and, thus, its proposed operations offer few new service or competitive benefits. However, the record shows that Delta's service proposal in this case--which relies exclusively on the operation of services with its own aircraft--would provide greater public benefits than the proposals of American or Tower, and we are tentatively selecting Delta with these considerations in mind.

Frequency Allocation

Continental and Delta each seeks 14 weekly frequencies for U.S.-Brazil services. Continental would use all 14 frequencies for Newark-Sao Paulo/Rio de Janeiro service; Delta would use seven frequencies for Cincinnati/Atlanta-Sao Paulo service and seven frequencies for New York (JFK)-Sao Paulo/Rio de Janeiro service.

We tentatively conclude that Continental's decision to serve Newark and Delta's decision to serve Atlanta/Cincinnati are choices that would offer significant public benefits for U.S.-Brazil passengers. By serving from their respective hubs, the carriers would provide the public with the broadest range of services for access to Brazil. Continental offers 343 flights at its Newark hub; Delta 763 flights at Atlanta and 459 at Cincinnati.²⁵ As demonstrated by their proposals, these services not only will provide valuable new service options to the local markets, but also viable new alternatives to the existing New York (JFK), Miami, and Dallas/Ft. Worth gateways, thus enhancing intergateway competition. Continental's proposed service at Newark also offers New York passengers a valuable choice of airport for Brazil service and the significant benefit of Continental's hub services at Newark. The civic parties participating in this case, the New Jersey parties in support of Continental, and the Georgia and Atlanta parties and the Cincinnati/Northern Kentucky parties in support of Delta, have provided ample evidence to demonstrate the importance of, and support for, the proposed services to their areas.²⁶ Because of these benefits, we tentatively conclude that the record warrants allocation of seven weekly frequencies for each of these services.

The issue then becomes whether we allocate the remaining seven weekly frequencies to Continental or to Delta, both of which would use them to serve the Newark/New York area--Continental from Newark and Delta from JFK. We have tentatively concluded that allocation of the remaining frequencies to Continental offers greater service and competitive benefits.

New York-Brazil is the second largest U.S.-Brazil market. Currently, all of the service in the market is operated from JFK. Continental's proposal offers the benefit of an alternative choice of airport for New York passengers. As noted in this proceeding, Newark International Airport is the sixth largest mainland U.S. international gateway with over six

²⁵ Continental Direct Exhibits, CO-506; Delta Direct Exhibits, DL-151.

²⁶ New Jersey Parties Direct Exhibits NJP-T-1; NJP-T-2; and Brief, 2, 7-9; Georgia and Atlanta Parties Direct Exhibits ATL-205; ATL-400; ATL-500 and Brief, 2-4. Cincinnati/Northern Kentucky Parties Direct Exhibits CVG-T-1, pp. 2-4, Volume I and Volume II; Brief, 2-3.

million passengers in its catchment area.²⁷ With Continental's service at Newark, the benefit of this airport choice is significant. Furthermore, an award of 14 frequencies to Continental affords the public the benefit of nonstop service to both Sao Paulo and Rio de Janeiro. Currently 14 weekly nonstop flights are operated between New York (JFK) and Rio, as opposed to 31 between New York and Sao Paulo. While Rio is served on a one-stop basis over Sao Paulo on flights by Brazilian carriers and would be so served by Delta's proposed services, the availability of additional nonstop services in this market provides a valuable service option.²⁸ In addition, officially noticeable traffic data and the existing JFK services amply demonstrate that a substantial market exists for nonstop service from the New York area to both Rio de Janeiro and Sao Paulo.²⁹ Thus, in awarding Continental the frequencies needed to offer daily service to both Brazilian points, we maximize the likelihood that Continental at its Newark hub can establish an effective and meaningful new U.S. competitive presence in the U.S.-Brazil market. This consideration should enhance Continental's ability to enter the Brazil market and to provide the significant public benefits resulting from that entry. Finally, an allocation of 14 weekly flights here will enhance Continental's participation in South American markets generally, important to Continental's efforts to develop a South American route network, and thereby increase Continental's competitive posture in the U.S.-South America market dominated by American and United.³⁰

Although Delta would also use the additional frequencies for service from New York, and would provide competitive services at JFK, it would not offer (a) a broad range of connecting service from a major hub, (b) a choice of airport and thus competition with JFK, (c) nonstop service to both Sao Paulo and Rio, or (d) the various competition-enhancing elements present only under Continental's proposal.

On the other hand, the allocation of seven weekly frequencies to Delta will enable it to offer competitive U.S.-Brazil services from its large Atlanta hub and to begin development of a South American service network which it has indicated in its submissions in this case that it seeks to do with an award here.³¹

²⁷ Brief of the New Jersey Parties at 2.

²⁸ Delta has argued that its proposed one-stop service to Rio over Sao Paulo is more efficient than Continental's proposed nonstop service to both markets (Brief at 33) and that Continental has the flexibility to combine Rio de Janeiro and Sao Paulo service on a single daily Newark round trip (Brief at 35, fn. 12). The issue before us is which proposal offers greater public benefits. As discussed in this order, Continental has demonstrated on the record that its proposal to offer nonstop service to both cities offers greater public benefits to the New York area than Delta's, and we have found its proposal credible. In these circumstances, we do not find Delta's efficiency arguments persuasive. Similarly, we are not persuaded by Delta's broad argument that the public's preference is for service at JFK (see Delta Brief at 36). As noted above, Continental operates services to numerous other Central and South America cities from Newark, several of which also receive service from JFK, and we have no reason to believe that it will not provide similar service in the U.S.-Brazil market.

²⁹ DOT-IR-3 and March edition of the *Official Airline Guide*.

³⁰ Delta argues that an award to it for JFK frequencies will create the opportunity to expand global competition (Brief at 24); while this may be true, this case's primary focus is the U.S.-Brazil market.

³¹ Delta Direct Exhibits DL-T-1, 10-11/16; Brief, 8.

Taking into consideration these combined factors, we tentatively conclude that the allocation of 14 weekly frequencies to Continental and seven to Delta best promotes our goals to improve service and competition in the relevant markets in this proceeding.

Other Considerations

A. Tower's Proposal

Several parties have criticized Tower for not following the evidentiary requirements in this case, particularly with respect to its traffic forecast and the actual capacity to be provided. In fact, Tower neither presented a city-pair market-by-market analysis of its projected traffic in this case, nor used the specified traffic base data required by the Department in developing its forecast. In addition, Tower's source for some of its forecast was "Company Records" which are not verifiable by the other parties.

We have previously addressed evidentiary submission irregularities and the importance of having a common standard for comparison of exhibits, as well as the need for a full explanation of all data in carriers' exhibits.³² There are notable flaws in Tower's presentation, particularly with respect to the lack of detail and documentation in its proposed traffic, and these flaws made it difficult to conduct a detailed comparison of Tower's proposal with those of the other applicants. We have considered whether these shortcomings reflected an intentional violation of our rules such as could warrant disqualification of Tower, and we concluded that they did not. It was clear, however, from Tower's responses that it did not fully appreciate the level of detail required in these cases, nor the importance of adhering to prescribed evidentiary sources and methodologies.³³ Therefore, we reiterate that it is the responsibility of counsel and carrier management to ensure compliance with the ground rules set forth in the instituting order and evidence request of a case. We remind all applicants that the failure to comply in future cases could lead to the disqualification or striking of exhibits filed by applicants in support of their proposals.

B. Delta's February 7, 1997 letter

On February 7, 1997, Delta notified the Department that Varig had terminated its code-share arrangement with Delta on February 3. Delta stated that its exhibits in this proceeding dealing with the code share should be disregarded and that arguments of other parties regarding Delta's "incumbency" in the market also should be disregarded.³⁴ By Notice dated February

³² See, e.g., Orders 89-9-36, 89-10-2, and 96-4-48.

³³ For example, Tower has stated that its failure to specify separately the level of traffic it would carry to Sao Paulo and Rio de Janeiro, notwithstanding the fact that it proposed nonstop service to each of these cities, is comparable to general estimates provided by other applicants with respect to the level of interline connecting passengers they expect to carry on their service. Brief of Tower at 22 and 23.

³⁴ Attached to Delta's letter is a letter from Delta to the Planning Director for Varig Brazilian Airlines stating that Delta's Director, International Alliances, will work with her counterpart at Varig to work out the details of the termination, noting that the code-share agreement allows termination by either party at the end of an IATA timetable period by giving written notice of at least 180 days.

11, 1997, the Department afforded all parties to this proceeding an opportunity to comment on the information in Delta's letter. Answers were due February 14 and replies February 18.

Continental, Tower, and the Georgia and Atlanta Parties filed answers. Continental also filed a motion to dismiss Delta's application. The New Jersey Parties, the Cincinnati/Northern Kentucky Parties, Delta, and Tower submitted replies. In addition, Continental filed a reply to the answers of Tower and the Georgia/Atlanta Parties.

Continental and the New Jersey Parties argue that Delta's submission "invalidates" its service proposal, "irrevocably taints" the proceedings in this case and requires the Department either to reopen the case--thereby delaying carrier selections-- or to dismiss Delta's application and select among the other applicants. It states that Delta's attempt to change its proposal to delete the code-sharing portion of its exhibits at this late stage is highly improper and prejudicial to the other applicants.

Tower supports Continental's position that Delta should be disqualified from further consideration in this proceeding and that its application should be dismissed. It also argues that a five-day period for comment on the changed circumstances of Delta's proposal is not sufficient due process for the other parties. In any event, Tower contends that the discontinuance of Delta's code-share operations with Varig does not warrant Delta's selection to replace Tower's service to Brazil in this proceeding.

Delta, the Cincinnati/Northern Kentucky Parties, and the Georgia and Atlanta parties oppose Continental's motion to dismiss, arguing that such action is not warranted and that Continental's motion is fundamentally flawed. Delta argues that Continental's motion is intended solely to keep its strongest competitor out of the case. Delta further states that it is not asking the Department to accept any additional information, that there is no conceivable basis for prejudice to Continental, and that dismissal of Delta's application would be highly prejudicial to Delta and would violate Delta's due process rights. The Georgia and Atlanta Parties express concern over the potential loss of service at Atlanta and maintain that the first selection in this case should be Delta's proposal for Cincinnati-Atlanta-Sao Paulo service.

We have decided to deny Continental's motion to dismiss Delta's application. We did not rely on any evidence in this record bearing on the Delta/Varig code-share to choose Delta over any of the other applicants in this proceeding. Rather, we relied upon its separate service proposal for Brazil in finding that Delta would provide greater public benefits than all other applicants except for Continental. In these circumstances, we determine that the substance of Delta's February 7 letter is immaterial to the outcome of this case and does not prejudice the position of any of the parties.

Backup Award

We have tentatively decided to select Delta as a backup to Continental's Newark-Brazil services and Tower as a backup for Delta's Atlanta service. Selections of these carriers for backup services will ensure that should either Continental at Newark and/or Delta at Atlanta

not inaugurate and maintain services, carriers will be authorized to enter the market quickly without further regulatory proceedings should their services be needed. While we have tentatively selected Continental's proposal for Newark over Delta's proposal at JFK, we have noted the service and competitive benefits of increasing service at New York. Delta has operations at New York and is therefore well situated to commence its proposed New York operations should Continental not commence all of its proposed Newark operations.

Tower's service at Miami with behind-gateway service to New York would provide valuable additional services in the two largest U.S.-Brazil markets should Delta not commence its proposed operations. Tower has experience providing scheduled service in the market under its temporary authority and also currently operates passenger and all-cargo charters between the U.S. and Brazil. It is, therefore, well positioned to commence operations should its backup authority be activated.

Certificate and Dormancy Conditions

As stated in our instituting order, we intend to issue the U.S.-Brazil authority in the form of temporary, experimental certificates of public convenience and necessity under 49 U.S.C. section 41102(c) and the duration of the authority awarded will be five years for the primary carriers and one year for the backup carriers, unless the latter authority is activated during that time, in which case, it will continue in effect for five years. Consistent with our standard practice, the authority to be awarded will be only for those points specifically proposed for service in the carriers' service plans and will not include all points in the United States or all points in Brazil.³⁵ We have tentatively decided to require institution of service within 90 days after the effective date of the certificates to be issued. Both applicants being awarded authority here indicated in their exhibits that a 90-day startup condition would be appropriate.³⁶ Also consistent with our standard practice, the frequencies allocated in this proceeding will be for one year's duration and will be subject to our standard 90-day dormancy condition, wherein frequencies will be deemed dormant if they are not operated for 90 days, except where service in the market is seasonal.

Motion for Confidential Treatment

Delta filed a Rule 39 motion for confidential treatment of O&D data between the United States and other international destinations other than Brazil. No objections to Delta's motion were filed. We have reviewed Delta's submissions under the disclosure guidelines of Rule 39 and have determined that they warrant confidential treatment. Because of the commercially sensitive nature of the information in these documents, including the numbers of passengers from international destinations, we have determined that the documents fall within the Freedom of Information Act exemption for proprietary information and would adversely affect the competitive position of an air carrier in foreign air transportation under section

³⁵ See Order 96-12-9 at 6.

³⁶ Continental Direct Exhibits CO-522; Delta Direct Exhibits DL-T-1 page 16.

40115 of Title 49 of the United States Code³⁷ Therefore, we conclude that it is in the public interest to grant Delta's motion.

ACCORDINGLY,

1. We tentatively select Continental Airlines, Inc., for award of primary authority to engage in scheduled foreign air transportation of persons, property and mail between Newark, New Jersey, on the one hand, and the terminal points Sao Paulo and Rio de Janeiro, Brazil, on the other hand;
2. We tentatively select Delta Air Lines, Inc., for award of primary authority to engage in scheduled foreign air transportation of persons, property, and mail between Atlanta, Georgia, on the one hand, and Sao Paulo, Brazil, on the other hand;
3. We tentatively select Delta Air Lines, Inc. for backup authority (to Continental's primary award) to engage in foreign scheduled air transportation of persons, property, and mail between New York (JFK), New York, on the one hand, and Sao Paulo/Rio de Janeiro, Brazil, on the other hand;
4. We tentatively select Tower Air, Inc. for backup authority (to Delta's primary award) to engage in foreign scheduled air transportation of persons, property, and mail between Miami, Florida, on the one hand, and Sao Paulo/Rio de Janeiro, Brazil, on the other hand;
5. We tentatively allocate Continental Airlines, Inc. 14 weekly frequencies to perform its proposed operations; and Delta Air Lines, Inc. 7 weekly frequencies should its backup certificate become activated;
6. We tentatively allocate Delta Air Lines, Inc. 7 weekly frequencies to perform its proposed operations; and Tower Air, Inc. 7 weekly frequencies should its backup certificate become activated;
7. We direct any interested parties having objections to our tentative decisions set forth in this order and in ordering paragraphs 1 through 6, above, to file their objections with the Department's Dockets, Docket OST-96-2016, U.S. Department of Transportation, 400 Seventh Street SW, Room PL-401, Washington, DC 20590, no later than 10 calendar days from the date of this order; answers thereto shall be filed no later than 5 calendar days thereafter;³⁸

³⁷ Under Rule 39, this confidentiality determination regarding the Motion for Confidential Treatment becomes effective 5 business days after the date of service of this order unless a petition for reconsideration, or a statement of intent to seek judicial review, is filed before the effective date.

³⁸ The original submission is to be unbound and without tabs on 8½" x 11" white paper using dark ink (not green) to facilitate use of the Department's docket imaging system.

8. If timely and properly supported objections are filed, we will afford full consideration to the matters or issues raised by the objections before we take further action;³⁹
9. If no objections are filed, we will deem all further procedural steps to have been waived, and proceed to enter a final order subject to Presidential review under section 41307 Subtitle VII of Title 49, the United States Code (Transportation);
10. We grant the motion of Delta Air Lines, Inc. for confidentiality under Rule 39 of our Procedural regulations;
11. We deny the motion of Continental Airlines, Inc. to dismiss Delta's application; and
12. We shall serve this order on American Airlines, Inc.; Continental Airlines, Inc.; Delta Air Lines, Inc.; Tower Air, Inc.; United Air Lines, Inc.; the Cincinnati/Northern Kentucky Parties; the Georgia and Atlanta Parties; the New Jersey Parties; the Ambassador of Brazil in Washington DC; the Federal Aviation Administration, and the U.S. Department of State (Office of Aviation Negotiations).

By:

PATRICK V. MURPHY
Deputy Assistant Secretary for
Aviation and International Affairs

(SEAL)

*An electronic version of this order is available on the World Wide Web at
<http://www.dot.gov/general/orders/aviation.html>.*

³⁹ As we are providing for the filing of objections to this tentative decision, we will not entertain petitions for reconsideration of this order.

Positions of the Parties

A. Comments of Applicants on Other Proposals

American argues that Continental will provide duplicate service between New York (via Newark) and Sao Paulo/Rio de Janeiro. It maintains that Delta already serves Brazil from four U.S. gateways through its Varig code-share arrangement and that Delta did not provide adequate detail for its traffic forecast as required by the Department concerning its code share, particularly on an O&D market by market basis or on indicating data sources for the code share forecast. Of Tower's proposal, American argues that Tower proposes service in the Miami-Sao Paulo/Rio de Janeiro market, a market which already receives more nonstop flights than any other U.S.-Brazil city-pair, but does not propose a daily pattern of service until 1998.

Continental argues that Delta's proposed JFK-Sao Paulo flight adds no significant new options to passengers or shippers since it is offered by Delta/Varig, and its JFK-Rio de Janeiro flight is only a one-stop service via Sao Paulo, being less attractive than the nonstop service Delta offers today on Delta/Varig flights, and that its proposed transatlantic connections require excessively long lay overs. Of Delta's Atlanta proposal, Continental states that it simply duplicates the Atlanta-Sao Paulo service offered today by Delta/Varig and that its proposal includes numerous double connections. Continental argues that Tower's proposed service offers only modest benefits, with less than daily service in markets which are already well-served. Continental states that although American would add a new city to the U.S.-flag route map, the Miami-Manaus market is tiny and already receives nonstop service.

Delta argues that if Continental is awarded authority, Continental should only be awarded 7 weekly frequencies; that Continental cannot claim that Newark is a new gateway and at the same time lay claim to the New York gateway's large base of existing traffic; that the Newark hub is not geographically well suited for carrying connecting traffic; and that Continental's proposed service consists of only two classes of service while Delta offers three (coach, business and first-class). Delta argues that it would be detrimental to the long term needs of the market to allow Tower to continue its sporadic and inefficient use of a Brazil designation at the expense of an award to Delta. It notes that Tower has no experience in operating either the B767 or A310 aircraft which it says it will acquire for its proposed services and offers no documentation as to the acquisition of such aircraft. In addition, Delta states that Tower did not fully comply with the Department's evidentiary request by not providing city-pair forecasts, not using the specified base year and traffic data base, and not providing explanatory notes, thus preventing reconstruction or analysis of Tower's forecast. Delta states that Tower's proposed services could be accommodated through the Brazil charter program. Regarding American, Delta states that an award to American would have the worst impact on competition in the U.S.-Brazil market, since it would only strengthen American's dominant stance, and that if American chose to serve Manaus, it could do so today by reallocating some of its existing 49 weekly frequencies.

Tower argues that Delta is already in the market, plans to continue its code-share relationship with Varig and does not include its existing service with Varig in its traffic forecast. Tower further states that Delta's timing of the new services are virtually identical to those of its code-share operations with Varig. Tower argues that Continental's forecast cannot be tested since

Continental does not provide fares it will charge or projection of operating and startup expenses. It also argues that Delta and Continental cannot both serve the New York-Brazil market, noting that over 90 percent of the traffic Continental forecasts is included in markets from which Delta has also forecast traffic. Tower states that American projects an increase from 50 passengers a day to almost 200 passengers a day for its proposed new service and states that failure to achieve this extreme stimulation will have a devastating impact on American.

B. Civic Parties

The New Jersey Parties state that Continental's Newark proposal will maximize the benefits to passengers and shippers in the U.S.-Brazil market by providing the first nonstop Newark-Sao Paulo and Newark-Rio de Janeiro service and thus serving the second largest U.S.-Brazil market (Newark/New York), opening a new gateway airport (Newark), and introducing a new competitor into the restricted U.S.-Brazil market. Of the U.S. gateways proposed in this proceeding, Newark is the only one without single-plane Brazil service, and Continental is the only applicant without on-line U.S.-Brazil authority and only Continental proposes Newark-Rio de Janeiro nonstop services. The Parties maintain that Continental's Newark-Brazil service will enhance competition more than any other applicant, will provide an attractive alternative to the existing service at the New York JFK gateway, and will provide intergateway competition for American and other carriers at the dominant Miami gateway. The Newark International Airport, they state, will be an effective competitor for Brazil traffic at the existing Atlanta, JFK and Miami gateways.

The Cincinnati/Northern Kentucky Parties state that the selection of Delta and allocation of at least 7 frequencies to implement the daily Cincinnati-Atlanta-Sao Paulo service will provide more substantial service benefits and greater competitive market structure enhancements than the other applicants will. They argue that Delta will promote greater intergateway competition by establishing direct service to Brazil at two major new U.S. gateways and will provide service in a region of the central and southeastern United States which now lacks convenient service to Brazil. Moreover, they state that Delta will be an effective competitor that will provide numerous and convenient on-line connections to Brazil from points in the extensive and underserved midwest/northern tier region. They maintain that Delta is the only applicant which can provide effective competition with American's major hub networks at Miami and Dallas/Fort Worth and Delta's Cincinnati/Atlanta proposal may operate as a competitive spur to United to provide direct Brazil service from its Chicago hub.

The Georgia and Atlanta Parties strongly endorse designating Delta as the third U.S. carrier. They state that Delta proposes a new southeastern gateway at Atlanta which can be a significant competitor to Miami and Dallas/Ft Worth; that the Atlanta hub provides nonstop connections to most major cities, providing passengers access to the entire U.S. with on-line service; that Delta will provide meaningful competition to American because Delta's system reaches so totally across the country from Atlanta and will also provide competition from JFK. The Parties argue that neither Continental nor Tower has viable proposals; that Continental can at best only support a single service that covers both Sao Paulo and Rio de Janeiro; and that Tower's proposal uses about half the frequencies it seeks in one year and its exhibits confuse rather than enlighten about aircraft to be used and obtained. Regarding American, they argue that it should not be seriously considered for additional frequencies since an award to American would have an adverse impact on the overall market structure.

Appendix A

CARRIER PROPOSALS IN U.S.-BRAZIL COMBINATION SERVICE CASE, OST 96-2016

| <u>Applicant</u> | <u>Routings¹</u> | <u>Wkly Freq.</u> | <u>Aircraft</u> | | <u>Seats</u> | <u>Proposed Passengers</u> | <u>% Local/Flow</u> | <u>Load Factor</u> | <u>Startup</u> |
|------------------|-----------------------------|-----------------------|-----------------|-------|--------------|--------------------------------|-------------------------|--------------------|----------------|
| American | MIA-MAO | 7 | 757-223ER | 188 | | 87,044 | 95%/5% | 63% | 4/1/97 |
| Continental | EWR-SAO | 7 | DC-10-30 | 242 | | 119,358 | 63%/37% | 68.5% | 90 days of |
| | EWR-RIO | 7 | DC-10-30 | 242 | | <u>114,543</u> | 82%/18% | 66% | award or |
| | | | | Total | 233,901 | | | whichever | 5/1/97, |
| | | | | | | | | | is later |
| Delta | CVG-ATL-SAO | 7 | 767-300ER | 212 | | 119,297 | 29%/71% | 77% | 90 days from |
| | JFK-SAO/RIO | 7 | 767-300ER | 212 | | <u>112,132</u> | 95%/5% | 72% | govt approvals |
| | | | | | | 231,429 | | | (US & Brazil) |
| | | | | | | | | | or 4/1/97, |
| | | | | | | | | | whichever is |
| | | | | | | | | | later |
| Tower | JFK-MIA-GRU | from 2-4 ² | B747 | | 470 | 97,672 ³ | 4 | | 68% 4/1/97 |

¹ City codes: JFK New York, MIA Miami, EWR Newark, CVG Cincinnati, ATL Atlanta, GRU & SAO Sao Paulo, RIO Rio de Janeiro, MAO Manaus.

² Tower proposes a graduated service, starting with three weekly flights and increasing up to seven flights. Tower states it will use the B747 at first and will use the B767/A310 when they are acquired (which Tower states in testimony will be Autumn of 1998 but exhibits show being used Winter 1997/98).

³ Tower gives only an overall total for both routes, not identifying destination points. From New York, Tower states it will carry 20,356 passengers; from Miami, 77,316 passengers.

⁴ Tower does not break out its passengers. Since it has no major domestic network, we assume its projected traffic consists of local traffic and interline connections.